

**MILLENNIUM CHALLENGE CORPORATION
CONGRESSIONAL NOTIFICATION**

April 27, 2005

PROGRAM:	Eligible Countries
APPROPRIATIONS CATEGORY:	FY 2004 Program Funds
OBLIGATION AMOUNT:	\$109,773,000

In accordance with section 610 (b)(1) of the Millennium Challenge Act of 2003 (the “Act,” Pub. L. 108-199, Division D), this is to advise that the United States of America, acting through the Millennium Challenge Corporation (MCC), has entered into a Compact with the Government of the Republic of Madagascar pursuant to Section 609 of the Act. The United States, acting through the MCC, and the Government of the Republic of Madagascar executed the Compact documents on April 18, 2005. The provisions of the Compact will enter into force pursuant to Section 1.3 of the Compact, including satisfaction of certain conditions set forth in Section 4.1.

A detailed summary of the Compact follows along with a copy of the text of the Compact.

**Summary of the Millennium Challenge Compact
with the Republic of Madagascar**

Poverty in Madagascar is overwhelmingly rural. Rice yields have consistently been among the world’s lowest over the last forty years and fertilizer use is one-twelfth the African average. In this setting, the most effective vehicle to reduce poverty is for the rural poor to invest in their land, employ proven technology to enhance productivity, improve farming methods, and sell to new markets. Consequently, the Government of the Republic of Madagascar (“GoM”) asked MCC to support a major effort to attack two of its root causes of poverty: a poorly-functioning financial system that fails to serve the rural poor and a weak land-titling system that fails to provide legally-recognized collateral to support credit and investments in poor rural areas. Further, the Malagasy believe that reforming the weak land-titling system will increase trust in the government and encourage further reform. Finally, improved property rights in land will also help reduce the incentive to engage in environmentally destructive practices, such as slash-and-burn farming, that threaten this uniquely diverse eco-system.

The Program will address rural poverty on two geographic levels: certain activities will be implemented on a national basis and other activities shall be implemented in five high potential agricultural Zones, one of which has already been identified.

The Land Tenure Project of this Compact supports formalizing the titling and surveying systems, modernizing the national land registry, and decentralizing services to rural citizens. The Finance Project includes measures to make financial services available to rural areas, improve credit skills training, and create a streamlined national payments system that is expected to bring delays in check settlement down from 45 to 3 days. The Agricultural Business Investment Project will

help support farmers and entrepreneurs identify new markets and improve their production and marketing practices.

Program Activities, Costs and Performance

FINANCIAL PLAN SUMMARY	Cost (\$ thousands)
1. Land Tenure	37,803
2. Finance	35,888
3. Agricultural Business Investment	17,683
4. Monitoring and Evaluation	3,375
5. Fiscal and Procurement Management and Audits	7,871
6. Program Administration	7,153
TOTAL ESTIMATED MCC CONTRIBUTION	109,773

A. Land Tenure Project (\$37.8 million over four years)

The informal and uncertain land ownership prevalent today means that poor families are reluctant to invest in improving the land they farm and have difficulty transferring property outside of people they know. In addition, much of the rural poor lack personal assets to invest themselves, even if they are willing to do so, and inadequately recorded land assets cannot be used as loan collateral. Consequently, producers cannot access credit to purchase supplies to expand production and reach domestic or export markets.

The existing Madagascar land registration system is an expensive and slow paper system with little penetration in rural areas. GoM has processed 1,500 titles per year over the past fifteen years. In 2002, there were 200,000 requests for land titles. Less than 7% of the country's land is titled. Based on current capacity, the backlog of registration requests could take over one hundred years to process.

In addition, the land tenure problem is the primary barrier to increased rural investment and limits agricultural productivity growth. Unregistered, untitled land cannot be used as collateral against loans to generate revenue. Recognizing this, GoM has already established a National Land Policy Framework (PNF).

Activities under this Project include:

- Supporting the PNF by developing new land laws and guiding implementation;
- Creating a land database using satellite imaging and improving the ability of the National Land Service Administration to restore damaged titles and surveys and issue new titles and certificates;
- Establishing local land management offices and training officials in land titling;
- Introducing standardized land registration into the project Zones; and
- Refining techniques for information gathering and dissemination on land tenure issues.

The Land Tenure Project aims to by its completion significantly reduce the time and cost of carrying out property transactions within the Madagascar land registration system and it is expected to issue titles or certificates covering approximately 250,000 hectares.

B. Finance Project (\$35.9 million over four years)

Of twelve African countries with populations between 10 and 20 million, Madagascar has the lowest density of banking accounts with only 208,000 (relative to a population of nearly 17 million), total formal banking system credit representing only 4% of GDP and microfinance available to only 5% of households. The country's archaic internal payments system continues to be a drag on economic development. Ground transport is still used to move documents and cash. Bank deposits are generally non-interest bearing and loaned out to finance large enterprises and the government deficit. Until 2004, most companies were not required to produce audited financial statements and there are currently only 70 certified accountants in the country.

Without a centralized reporting system or widespread use of consistent financial reporting standards, lenders cannot verify the creditworthiness of applicants, thus, making lending decisions very risky. Local banks specializing in small loans are almost non-existent. Routine transfers between banks can take up to 45 days, making banking difficult if not impossible for the rural poor. The financial sector activities are designed to reduce risk in the country's financial system which will contribute to the increasing availability of financial services in rural areas.

Activities under this Project include:

- Improving financial system efficiency by modernizing banking laws and laws regulating financial instruments and markets;
- Mobilizing rural savings by making new treasury instruments available to savings institutions, entrepreneurs, and households;
- Making National Savings Bank savings products available in rural areas and establishing Micro Finance Institutions (MFIs) credit lines;
- Improving credit skills training and accounting standards to improve the creditworthiness of borrowers; and
- Modernizing the interbank payment system to reduce risk and bring delays in settlement down from 45 days to 3 days.

At completion, the Financial Sector Reform Project should result in a more efficient banking system with a larger number of households having access to formal loan and savings products.

C. Agricultural Business Investment Project (\$17.7 million over four years)

The agricultural business investment activities are designed to build local and regional capacity to identify and access profitable agribusiness market opportunities which will increase investments and, thereby, incomes in rural areas. This Project will identify Madagascar's best

investment opportunities. In addition, there will be a large rural information campaign and training programs in agribusiness technology and management and marketing skills.

Activities under this Project include:

- Creating and operating five Agricultural Business Centers (ABCs) in the five Zones to train rural farmers and entrepreneurs in good business practices and identifying the Zones;
- Establishing a National Coordinating Center (NCC) to link the five ABCs with Malagasy government agencies;
- Identifying investment opportunities by researching local, regional and international markets and communicating these to local farmers and entrepreneurs; and
- Teaching technical and business management and marketing skills in the five Zones.

The Agricultural Business Investment Project is designed to complement the land titling and financial reform activities by providing the knowledge needed to improve the productivity of farmers and entrepreneurs. The Project will identify the five targeted Zones in which the Program activities will be undertaken. It should also significantly improve production technologies and the market access capacity of the beneficiaries.

D. Measuring Outcome and Impact (\$3.4 million)

The objective of the Program is to reduce poverty in Madagascar through increasing investment in rural areas. The three Program components will be evaluated based on their contribution to three principal indicators:

- increase in household income in each of the Zones;
- increase in land productivity in each of the Zones (*e.g.*, agricultural output per hectare); and
- increase investment in each of the Zones.

These indicators, together with others at the individual Project activity level (described in the table below), will be used to measure the impact of the Program and implementation progress in accordance with the guidelines set forth in the Monitoring and Evaluation Plan.

MCC and Madagascar have agreed to a series of benchmark indicators to measure progress on the Compact. MCC is also providing initial funding under Section 609(g) of the Millennium Challenge Act to initiate baseline data collection before the Compact enters into force. The use of such funds will provide baselines for the three indicators and would have independent capacity-building value to the Malagasy National Institute for Statistics.

The tables below summarize certain of the anticipated interim measurements and estimated targets for each Project.

Land Tenure Project Activities	Measures	Estimated Targets
<ul style="list-style-type: none"> ▪ Support the Development of the Malagasy National Land Policy Framework ▪ Improve the Ability of the National Land Service Administration to Provide Land Services ▪ Decentralization of Land Services ▪ Land Regularization in Target Zones ▪ Information Gathering, Analysis and Dissemination 	<ul style="list-style-type: none"> ▪ Submission and passage of new legislation that recognizes improved land tenure procedures, documents (certificates) and techniques ▪ Percentage of land documents inventoried, restored, and/or digitized ▪ Percent of land in pilot sites in the Zones that is securely demarcated and registered ▪ Average time and cost required to carry out property transactions at national and local levels 	<ul style="list-style-type: none"> ▪ Land legislation that recognizes improved land tenure procedures adopted by Month 15. ▪ 100% of approximately 800,000 documents inventoried, 300,000 damaged land documents restored and 400,000 of the existing documents digitized. ▪ 100% of approximately 250,000 hectares demarcated

Finance Project Activities	Measures	Estimated Targets
<ul style="list-style-type: none"> ▪ Promote Legal and Regulatory Reform ▪ Reform Sovereign Debt Management and Issuance ▪ Strengthen the National Savings Bank ▪ Provide New Instruments for Agribusiness Credit ▪ Modernize National Interbanks Payments System ▪ Improve Credit Skills Training, Increase Credit Information and Analysis 	<ul style="list-style-type: none"> ▪ Submission, passage, and implementation of new legislation that permit a multi-tiered financial system as recommended by outside experts and relevant commissions. ▪ Number of holders of smaller denomination treasury bills ▪ Volume of treasury bill holdings ▪ Number of treasury bills held outside of Antananarivo ▪ Check clearing delay ▪ Volume of funds in the payment system ▪ Volume of microfinance institution (MFI) lending in the targeted zones ▪ MFI portfolio-at-risk delinquency rate ▪ Reporting of credit and payment information to a central database 	<ul style="list-style-type: none"> ▪ Legislation permitting a multi-tiered financial system submitted by Month 5. ▪ Check clearing delay reduced from 45 days to 3 days ▪ Growth rate of volume of funds in the payment system to exceed GDP growth rate ▪ MFI portfolio-at-risk delinquency rate reaches and remains steady at 4-6% ▪ \$5 million increase in MFI lending in the Zones

Agriculture Business Investment Project Activities	Measures	Estimated Targets
<ul style="list-style-type: none"> ▪ Create and Operate Five ABCs ▪ Create NCC and Coordinate Activities with GoM Ministries and ABCs and Identify the Zones ▪ Identify the Investment Opportunities ▪ Build Management Capacity in the Zones 	<ul style="list-style-type: none"> ▪ Zones identified and cost-effective investment strategies developed ▪ Number of farms and enterprises employing technical assistance received ▪ Number of farms/enterprises receiving/soliciting information on business opportunities 	<ul style="list-style-type: none"> ▪ Five Zones identified and cost-effective investment strategies developed by Month 12 ▪ One agribusiness investment strategy developed for each zone ▪ Value of change in marketing and production techniques exceeds costs

E. Fiscal and Procurement Management and Audits (\$7.9 million)

Financial administration, procurement and financial and performance audits are budgeted at \$7.9 million over four years.

Funds control for the MCA Program will be managed by a separate fiscal agent identified using a competitive process. A modified version of Madagascar's procurement law -- which was written with technical assistance from international donors -- will govern procurements in the Compact. Disbursements will be made periodically based on performance, projected cash requirements, and compliance with provisions in the Compact and related documents.

The Program will be supplemented by a fiscal accountability plan, setting forth principles on funds control, accounting, financial reporting, auditing, and disbursement.

F. Program Management (\$7.2 million)

Program management, which includes personnel, office space, equipment, and general administrative costs, is budgeted at approximately \$7.2 million over four years.

The management and control structure is consistent with a priority identified by GoM in the PRSP: a commitment to public-private partnership in the management of key public enterprises. MCA-Madagascar will include representatives of GoM, the private sector, NGOs and intended beneficiaries. They will recruit key managers from both the public and private sectors. A simplified version of this structure is presented below.

MCA Madagascar will be headed by a Steering Committee which will act like a Board of Directors for MCA-Madagascar and be composed of the Chief of Staff of the President; the Secretaries General of each of the following Ministries: Agriculture, Livestock and Fisheries; Economy, Finance and Budget; Industry, Commerce and Private Sector Development; and three non-government members (e.g., civil society or private sector representatives) who will be members of an Advisory Council.

The Steering Committee will appoint a management team, composed of a Managing Director, a Manager of Administration and Finance, a Manager of Monitoring and Evaluation, a Manager of Procurement, and three Project Managers with responsibility for each of the three project areas. MCC intends to place one, or possibly two, MCC field representative(s) in Madagascar to monitor and provide support to MCA-Madagascar (including full observer and information rights with respect to the Steering Committee). However, MCA-Madagascar will have the primary role for Program implementation and management.

The Advisory Council will be an independent body made up of beneficiary representatives (including civil society and private sector representatives) who will have a regular opportunity to provide the Steering Committee and MCA-Madagascar management with their views or recommendations on the performance and progress of implementation.

Other Highlights

Consultative Process: In developing the concepts for the activities covered in this Compact, GoM engaged in a consultative process solely focused on MCC. An introductory national workshop was organized on September 16, 2004 (consisting of more than 350 participants, including President Ravolomanana) to describe the MCA and discuss obstacles to economic growth and poverty reduction.

GoM then organized six regional consultative workshops, each consisting of 50 to 150 representatives of the business community, non-governmental organizations, civil society and donors in Antsiranana, Antsirabe, Mahajanga, Toliary, Fianarantsoa, and Toamasina and one national workshop in Antananarivo. During this period, GoM also ran radio and TV broadcasts on the MCA, soliciting on-air input, and published newspaper advertisements that announced meetings and called for submission of proposal ideas.

There is broad agreement among the Malagasy and donors that the activities suggested in the Malagasy Compact proposal are priorities for addressing poverty reduction through economic growth.

Sustainability: The Program activities are largely focused on promoting investment opportunities through unleashing the rural private sector. Sustainability will result from rural producers taking advantage of the increased access to financial resources and information. A number of Program activities will be reinforced by a system of graduated user fees for services, including land titling, registration, credit reporting, banking services, and technical assistance provided by the ABCs.

Environment: Madagascar is home to some 10,000 endemic plant species, 316 endemic reptile species and 109 endemic bird species. It is also home to 71 primates found only there. This unique eco-system is threatened by the prevalence of slash and burn agriculture. Instituting secure land tenure will confer an incentive on landowners to make investments that preserve and enhance the productivity of the land's natural capital rather than practice destructive farming techniques. The Agricultural Business Investment Project will encompass sustainable agriculture principles to design interventions sensitive to the environment.

Donor Coordination: The Program complements and supplements efforts by other donors in each of the areas being addressed. Increasing rural incomes is the focus of the Malagasy national development strategy and numerous donors are supporting the achievement of this goal. The EU, World Bank, IFAD, FAO and AFD are all active in supporting various elements of the PNF. Similarly, World Bank, UNDP, AFD, ILO and USAID have funded activities to build capacity of micro-finance institutions. Finally, IFC and USAID efforts will be complemented by the Agricultural Business Investment Project.

Summary and Conclusion

Madagascar has undertaken structural reforms, created a more favorable environment for private investment and taken steps to integrate into the world economy. These policies have improved macroeconomic stability and sustained economic growth. The greatest challenge, however, is to ensure that growth translates into improvements in the lives of the poor. Growth needs to be brought to rural areas: getting the agriculture sector to grow and diversify, linking farmers to markets. Farmers must move beyond subsistence agriculture and start producing for export and for local processing if macroeconomic stability is to be translated into poverty reduction.

The basic premise of the Millennium Challenge Corporation is that establishing the right conditions is essential for economic growth and foreign aid effectiveness. The Madagascar Program establishes the proper conditions: land ownership, access to capital, and utilizing production and management know-how to reduce poverty.

This Program will have a positive economic impact on Madagascar: increased land security will result in more productive and environmentally friendly agricultural practices as well as improve access to credit in rural areas; financial sector reform includes measures to make financial services available to rural areas, improve credit skills training, and create a streamlined national payments system; and, agribusiness investment activities will support farmers and entrepreneurs as they move away from subsistence agriculture to more modern, market-based production.